



## **FEDERAL RESERVE SYSTEM**

### **12 CFR Part 234**

#### **Regulation HH; Docket No. R-1455**

#### **RIN No. 7100 AD-94**

#### **Financial Market Utilities**

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Final Rulemaking.

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**SUMMARY:** The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act” or “Act”) permits the Board of Governors of the Federal Reserve System (the “Board”) to authorize a Federal Reserve Bank to establish and maintain an account for, and through the account provide certain financial services to, financial market utilities (“FMUs”) that are designated as systemically important by the Financial Stability Oversight Council (the “Council”). In addition, the Dodd-Frank Act permits a Reserve Bank to pay interest on the balances maintained by or on behalf of a designated FMU. The Board is promulgating regulations to implement these provisions of the Dodd-Frank Act.

**DATES:** This final rule is effective [insert date 60 days from the date of publication in *Federal Register*.]

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## **SUPPLEMENTARY INFORMATION:**

### **I. Background**

#### *A. Dodd-Frank Wall Street Reform and Consumer Protection Act*

FMUs, such as payment systems, central securities depositories, and central counterparties, are critical components of the nation's financial system that provide the essential infrastructure to clear and settle payments and other financial transactions, upon which the financial markets and the broader economy rely to function effectively. FMUs operate multilateral systems in which financial institutions, such as banks, participate pursuant to a common set of rules and procedures, a technical infrastructure, and a risk-management framework.<sup>1</sup>

Title VIII of the Dodd-Frank Act, titled the "Payment, Clearing, and Settlement Supervision Act of 2010," was enacted to mitigate systemic risk in the financial system and to promote financial stability, in part, through an enhanced supervisory framework for FMUs designated as systemically important by the Council.<sup>2</sup> Designation by the Council makes an FMU subject to the supervisory and risk reduction framework set out in Title VIII of the Dodd-Frank Act. This framework includes risk management standards, promulgated by the designated FMU's Supervisory Agency, that take into consideration relevant international standards and existing prudential requirements, with the objectives of promoting robust risk management and safety and soundness of the

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<sup>1</sup> Under section 803 of the Act, an FMU is defined as a person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person. 12 U.S.C. 5462(6).

<sup>2</sup> The Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376, was signed into law on July 21, 2010. Section 803(9) of the Act authorizes the Council to designate an FMU for enhanced supervision when the Council finds, among other things, that the failure of, or a disruption to the functioning of, an FMU would create, or increase, the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the financial system of the United States. 12 U.S.C. 5462(3) and (9).

designated FMU, reducing systemic risks, and supporting the stability of the broader financial system.<sup>3</sup> The framework also includes *ex ante* review of changes to the rules, procedures, or operations of a designated FMU that could materially affect the nature or level of risk presented by the designated FMU, enhanced annual examinations of designated FMUs, and enhanced enforcement and information collection provisions.

In addition to these provisions, section 806(a) of the Act permits the Board to authorize a Federal Reserve Bank (“Reserve Bank”) to establish and maintain an account for a designated FMU and provide to the designated FMU the services listed in section 11A(b) of the Federal Reserve Act (12 U.S.C. 248a(b)) that the Reserve Bank is authorized to provide to a depository institution, subject to any applicable rules, orders, standards, or guidelines prescribed by the Board.<sup>4</sup> The services listed in Section 11A(b) include wire transfers, settlement, and securities safekeeping, as well as services regarding currency and coin, check clearing and collection, and automated clearing house transactions. Section 806(c) of the Dodd-Frank Act permits a Reserve Bank to pay earnings on balances maintained by or on behalf of a designated FMU in the same manner and to the same extent as the Reserve Bank may pay earnings to a depository institution under the Federal Reserve Act, subject to any applicable rules, orders, standards, or guidelines prescribed by the Board.

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<sup>3</sup> Pursuant to section 803(8) of the Act, the “Supervisory Agency” generally means the Federal agency that has primary jurisdiction over a designated FMU under Federal banking, securities, or commodity futures law, including the Securities and Exchange Commission (SEC) with respect to a designated FMU that is a clearing agency registered with the SEC, the Commodity Futures Trading Commission (CFTC) with respect to a designated FMU that is a derivatives clearing organization registered with the CFTC, and the Board with respect to a designated FMU that is an institution subject to the Board’s jurisdiction as described in section 3(q) of the Federal Deposit Insurance Act. The Board is also the Supervisory Agency for any designated FMU that is otherwise not subject to the jurisdiction of any agency as listed in section 803(8) of the Act.

<sup>4</sup> Section 806(a) of the Act also permits the Board to authorize a Reserve Bank to establish deposit accounts under the first undesignated paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 342).

On March 4, 2013, the Board published a notice of proposed rulemaking (“NPRM”) to amend Regulation HH by adding two new sections set to out the conditions and requirements for a Reserve Bank to open and maintain accounts for and provide financial services to designated FMUs, as well as to set out provisions regarding a Reserve Bank’s payment of interest on the balances maintained by a designated FMU at the Reserve Banks. The public comment period for the NPRM closed on May 3, 2013.

## **II. Summary of Public Comments and Analysis**

The Board received five comment letters on the NPRM.<sup>5</sup> Comments were submitted by three entities that were designated FMUs or affiliates of designated FMUs, one banking trade association, and an individual at a university-based research center. The Board considered these comments in developing its final rule as discussed in more detail below.

### *A. Section 234.1(b) – Purpose and scope.*

Proposed § 234.1(b) clarified that Part 234 also includes standards, restrictions, and guidelines for the establishment and maintenance of an account at, and provision of financial services from, a Reserve Bank for a designated FMU. Proposed § 234.1(b) also clarified that Part 234 confirms the terms under which a Reserve Bank may pay a designated FMU interest on the designated FMU’s balances held at the Reserve Bank. The Board did not receive any comments regarding its proposed amendments to § 234.1(b) and is adopting revised § 234.1(b) as proposed.

### *B. Section 234.6 – Access to Reserve Bank accounts and services.*

*Generally sound financial condition.* Proposed § 234.6 set out the conditions and

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<sup>5</sup> The comment letters are available at [http://www.federalreserve.gov/apps/foia/ViewComments.aspx?doc\\_id=R-1455&doc\\_ver=1](http://www.federalreserve.gov/apps/foia/ViewComments.aspx?doc_id=R-1455&doc_ver=1).

requirements for a Federal Reserve Bank to establish and maintain an account for, and provide services to, a designated FMU pursuant to section 806(a) of the Act. As noted in the NPRM, the proposed terms and conditions are designed to provide the Federal Reserve Bank and the Board with sufficient information to assess a designated FMU's ongoing condition as it pertains to the FMU's ability to settle promptly and to manage its settlement process and Reserve Bank account(s) safely.<sup>6</sup> Proposed § 234.6(b) required that a Reserve Bank ensure that its establishment and maintenance of an account for, or provision of services to, a designated FMU does not create undue credit, settlement, or other risks to the Reserve Bank and, in this regard, sets out minimum conditions that a designated FMU must meet, in the Reserve Bank's judgment, in order for the Reserve Bank to establish and maintain an account for, or provide services to, a designated FMU. The minimum requirements are set out in proposed § 234.6(b)(1) through (4).

Proposed § 234.6(b)(1) required the designated FMU to be in generally sound financial condition. One commenter supported the proposed requirements regarding sound financial condition. Two commenters opposed adoption of the "generally sound financial condition" standard. The commenters opposed generally stated that the designated FMU's compliance with requirements imposed by its own supervisor regarding financial resources and risk management should suffice for the Board's standard for a Reserve Bank's maintenance of an account for and provision of services to the designated FMU. In addition, the commenters stated that the imposition of the

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<sup>6</sup> As noted in the NPRM, unlike depository institutions, designated FMUs do not have regular access to discount window lending, so the Board expects that Reserve Banks will provide accounts and services, and designated FMUs will structure their settlement processes and use of Reserve Bank accounts and services, in a manner that would seek to avoid inadvertent intraday account overdrafts where possible. Nevertheless, there may be instances where a designated FMU could incur an inadvertent overdraft. In such cases, the Board would expect a designated FMU to have the resources to promptly rectify any such overdrafts.

additional subjective “generally sound” condition could cause confusion in the market as to whether the designated FMU will remain eligible to rely on the Reserve Bank account and services. Alternatively, the commenters argued that, if the Board believes that a designated FMU’s eligibility to continue to benefit from a Reserve Bank account and services requires a financial condition standard in addition to that imposed by its supervisor, the Board should provide more clarity regarding the standard to permit the designated FMU and its participants to evaluate the risk that the designated FMU may lose access to the Reserve Bank account and services.

After considering the public comments, the Board continues to believe that the sound financial condition requirement should be retained as a minimum condition for access to Reserve Bank accounts and services. Such a requirement is a basic condition similar to requirements placed on state-member banks.<sup>7</sup> The condition makes clear that designated FMUs seeking to establish or maintain access to Reserve Bank accounts and services, at a minimum, must be solvent and capable of meeting their obligations arising through their use of Reserve Bank accounts and services. Although the requirements imposed by a designated FMU’s Supervisory Agency regarding financial resources and risk management may be a key consideration, the design of the Supervisory Agency’s financial requirements may not be focused on the impact of the designated FMU on its settlement bank. The Board believes that in order for the Reserve Bank to conduct its own risk management, it is important that the Reserve Bank have the ability to judge the financial condition of account holders on its balance sheet. A designated FMU’s unexpected financial stress could have a negative impact on its ability to appropriately

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<sup>7</sup> Section 9(4) of the Federal Reserve Act (12 U.S.C. 322) requires the Board to consider the financial condition of any State bank applying for membership in the Federal Reserve System.

manage its Reserve Bank account.

In response to the comments recommending more clarity regarding the generally sound financial condition requirement, the Board has inserted additional detail regarding the standard in the final rule. For purposes of access to Reserve Bank accounts and services pursuant to Regulation HH, the final rule clarifies that “generally sound financial condition” includes maintenance of sufficient working capital and cash flow to permit the designated FMU to continue as a going concern and to meet its current and projected operating expenses under a range of scenarios. In judging whether a designated FMU is in generally sound financial condition, therefore, the Reserve Bank will look to both the overall balance sheet solvency of the designated FMU as a “going concern” as well as its ability to meet its general business obligations through current and projected cash flows to provide the Reserve Bank with some indication that the accountholder is operating on a reasonably sound financial basis and will continue as a going concern, even in various financial stress scenarios. In reaching this judgment, the Reserve Bank will take into account the designated FMU’s compliance with relevant financial resource requirements of its Supervisory Agency and the views of the Supervisory Agency regarding the overall financial condition of the designated FMU.

*Supervisory Agency requirements.* Proposed § 234.6(b)(2) required the designated FMU to be in compliance, based on information provided by the Supervisory Agency, with requirements imposed by the Supervisory Agency regarding financial resources, liquidity, participant default management, and other aspects of risk management. One commenter pointed out that proposed § 234.6(b) made a designated FMU’s compliance with the minimum conditions in proposed § 234.6(b)(1) through (4)

“in the Federal Reserve Bank’s judgment,” and this could be interpreted as the Reserve Bank exercising its own judgment as to whether the designated FMU was in compliance with requirements imposed by its Supervisory Agency. The commenter also recommended that the final rule require an explicit statement from the Supervisory Agency as evidence of compliance with its rules and requirements instead of imposing the judgment of the Federal Reserve Bank in this determination.

The Board did not intend the commenter’s interpretation of these provisions and is revising the final rule to provide clarity. In the final rule, the requirement regarding compliance with the Supervisory Agency’s requirements regarding financial resources, liquidity, participant default management, and other aspects of risk management has been moved to a separate sentence in the text of § 234.6(b) and thus is not subject to the phrase “in the Federal Reserve Bank’s judgment,” which covers the remaining conditions set out in § 234.6(b)(1) through (3). In addition, the requirement in the final rule clarifies that the designated FMU’s compliance with the Supervisory Agency’s regulatory and supervisory requirements is to be “determined by the Supervisory Agency.” Compliance with the Supervisory Agency’s regulatory and supervisory requirements regarding financial resources, liquidity, participant default management, and other aspects of risk management is an important consideration for a Reserve Bank account and services, but the Board intends for the Reserve Bank to consult with the Supervisory Agency only in this regard and not for the Reserve Bank to conduct its own review for accounts and services purposes.

*Compliance with Board policies.* Proposed § 234.6(b)(3) required that a designated FMU be in compliance with Board orders and policies, Federal Reserve Bank



operating circulars, and other applicable Federal Reserve requirements regarding the establishment and maintenance of a Reserve Bank account and the receipt of financial services from a Reserve Bank. One commenter stated that it is necessary and appropriate to require a designated FMU to be in compliance with these provisions. Another commenter noted that, in some cases, Board orders for granting certain types of FMUs access to Reserve Bank services may need to be tailored in a manner different than existing provisions applied to depository institutions, such as permitting ongoing multiple accounts. As noted in the NPRM, the Board expects that Reserve Banks would enter into account and service agreements with designated FMUs that are generally consistent with the provisions of existing Reserve Bank operating circulars for such services, but recognizes that there may be a need for some flexibility to tailor certain parts of such agreements or provide for certain restrictions because of the wide variety of organizations, operations, and business models presented by designated FMUs. As set out in proposed §§ 234.6(a) and (b)(2), the Board's authorization order may, as necessary for a particular designated FMU, include authorization for the Reserve Bank to enter into an agreement with the designated FMU that provides for modification of the terms in existing operating circulars for the approved services and supersedes such operating circular terms. In order to provide clarity, the final rule states in § 234.6(b)(2) that a designated FMU must be in compliance with Reserve Bank account agreements and, as applicable, operating circulars and other Federal Reserve requirements.

*Ongoing ability to meet account obligations.* Proposed § 234.6(b)(4) required the Reserve Bank to determine that the designated FMU can demonstrate an ongoing ability, including during periods of market stress or a participant default, to meet all of its

obligations under its agreement for a Reserve Bank account and services. One commenter suggested that it would be useful for the Board to further clarify the criteria and expectations that will be used in assessing the adequacy of the demonstration of ongoing ability to meet account obligations and how such assessments will be conducted. This commenter expressed concern that inclusion of this requirement without further clarification presents the possibility of a new set of standards being established in parallel to the existing regulatory framework and substantially increasing regulatory uncertainty and burden for designated FMUs.

The Board believes that it is important that a designated FMU seeking Reserve Bank accounts and services demonstrate an ability to (1) maintain well-managed and well-controlled settlement operations, including the ability to monitor and process transactions throughout the day in a timely and controlled manner to and from its Reserve Bank account, (2) monitor and maintain account balances at all times during the day sufficient to avoid intraday overdrafts, and (3) mobilize liquid resources in a timely manner to fund its account as necessary given its intended use of the account and any regulatory requirements for sound and timely settlement of its transactions. In order to support these objectives and in response to the public comments, the Board has included in §234.6(b) of the final rule additional detail regarding the minimum condition for a designated FMU to have an ongoing ability to meet all of its obligations under its agreement for a Reserve Bank account and services. The final rule clarifies that a designated FMU's ongoing ability to meet its Reserve Bank account obligations includes maintaining (i) sufficient liquid resources to meet its obligations under the account agreement; (ii) the operational capacity to ensure that such liquid assets are available to

satisfy the account obligations on a timely basis in accordance with the account agreement; and (iii) sound money settlement processes designed to adequately monitor its Reserve Bank account on an intraday basis, process money transfers through its account in an orderly manner, and complete final money settlement no later than the value date.

In assessing the adequacy of a designated FMU's ongoing ability to meet account obligations, the Board will look in the first instance to existing requirements imposed by a designated FMU's Supervisory Agency with regard to settlement, liquidity risk management and default procedures as well as operational risk management. The Board, however, may impose additional conditions, such as minimum balance requirements, restrictions on outgoing payments that would cause a designated FMU's account to be overdrawn, or limitations on receipt of securities against payment, on a designated FMU's use of Reserve Bank accounts and services if in the Board's judgment it believes the designated FMU's settlement practices introduce risk to the Reserve Bank.

*Termination of accounts or services.* Proposed § 234.6(e) stated that, in addition to any right that a Reserve Bank has to limit or terminate an account or the use of a service pursuant to an agreement, the Board may direct the Reserve Bank to impose limits, restrictions, or other conditions on the availability or use of a Reserve Bank account or service by a designated FMU, including directing the Reserve Bank to terminate the use of a particular service or to close the account. One commenter supported the termination provisions stating that account or service termination or restriction are consistent with sound risk management and supervisory oversight. Another commenter raised concerns that a designated FMU's access to a Reserve Bank account and services may be terminated during periods in which the accounts and services are

critical and would be difficult for the designated FMU to replace. This commenter stated that market stability demands a clear statement by the Board in the final rule that (i) termination would be based on clearly defined standards, (ii) a decision to terminate will consider not only risks of continuing to maintain the Reserve Bank account and services, but also the systemic effects of terminating them, and (iii) in the event of such termination, the Board will cooperate with the designated FMU to provide for a transition to private sector services that is as smooth and seamless as is reasonably possible.

The Board is mindful of the critical role played by designated FMUs in the markets they serve and that an unanticipated termination of a designated FMU's access to an existing Reserve Bank account and services could have an adverse impact on the designated FMU and the market. The Board believes, however, that it must retain broad discretion to close an account or restrict services provided to an accountholder when it deems it necessary.<sup>8</sup> In making a decision to direct a Reserve Bank to terminate a designated FMU's account or services, the Board would consider, among other factors, the impact that termination of a designated FMU's account and services would have on participants in the designated FMU and financial markets more broadly, as well as the risk presented by the designated FMU's account to the Federal Reserve. The Board would expect to balance the various factors involved in the decision before directing the Reserve Bank to terminate the account or service. In order to reflect this process, § 234.6(d), the termination provision in the final rule, includes a sentence that requires a Reserve Bank to consult with the Board regarding continued maintenance of an account

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<sup>8</sup> The account arrangements that the Reserve Banks have with depository institutions also provide the Reserve Bank with the discretion to terminate an account without substantive preconditions. Section 2.10 of the Reserve Banks' Operating Circular 1 (Account Relationships) permits the Reserve Bank to terminate an account "at any time by notice to the Account Holder but will endeavor to give not less than five business days prior notice."

or provision of services if the Reserve Bank determines that a designated FMU no longer complies with one or more of the minimum conditions in § 234.6(b). A decision by the Board to direct a Reserve Bank to restrict or terminate an account or service will be made only after considering all the relevant facts and circumstances.

*C. Section 234.7 - Interest on balances.*

Proposed § 234.7 clarified the authority of a Reserve Bank to pay interest on any balance that a designated FMU maintains in its account with that Reserve Bank. In particular, proposed § 234.7(b) provides that interest paid by a Reserve Bank on balances maintained by a designated FMU in its Reserve Bank account shall be at the rate paid on balances maintained by depository institutions or another rate determined by the Board from time to time, not to exceed the general level of short-term interest rates. One commenter supported this section as an implementation of the statutory provisions of section 806(c) of the Act. The Board did not receive any comments objecting to proposed § 234.7, and the Board is adopting it in the final rule as proposed.

*D. Miscellaneous issues.*

In addition to suggestions for revisions in the proposed text of the regulation as discussed above, commenters also raised various concerns regarding the impact of the proposal on various aspects of a designated FMU's business or operations and the financial markets more generally. These comments are discussed in more detail below.

*Protection of confidential supervisory information.* One commenter raised concerns that the proposed rule suggested that confidential information regarding the designated FMU necessary to determine compliance with the proposed conditions would

be shared with Reserve Bank personnel responsible for offering priced services, such as the Fedwire Funds Transfer service. The commenter suggested that the Board should do its own evaluation of a designated FMU's compliance with the conditions and then certify to the Reserve Bank that the designated FMU meets all the requirements for an account.

Confidential information regarding a designated FMU that a Reserve Bank may assess to determine compliance with the proposed conditions generally cannot be shared with Reserve Bank personnel responsible for offering priced services under existing Board policies and requirements. The Federal Reserve has long exercised great care to avoid actual or apparent conflict between its role as a provider of services and its role as a regulator, supervisor, and lender.<sup>9</sup> In particular, Reserve Bank personnel involved in monetary policy, bank supervision, or the lending function are generally prohibited from providing confidential information obtained in the course of their duties to Reserve Bank priced-service personnel.<sup>10</sup> For example, in opening, maintaining, and terminating accounts for depository institutions, the Reserve Banks' credit risk management functions may review and assess certain confidential information, including confidential supervisory information, regarding the condition of the institution and risks it might pose to the Reserve Bank. The credit risk management function in a Reserve Bank, however, is prohibited from sharing such information with any priced-service personnel and must handle such information in accordance with the Board's requirements governing

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<sup>9</sup> See "Standards Related to Priced-Service Activities of the Federal Reserve Banks" (1984), which can be found at [http://www.federalreserve.gov/paymentsystems/pfs\\_standards.htm](http://www.federalreserve.gov/paymentsystems/pfs_standards.htm).

<sup>10</sup> The policy provides an exception to this restriction when such action fulfills an important supervisory objective, preserves the integrity of the payment mechanism, or protects the assets of the Reserve Bank. In such cases, information will be provided on a need-to-know basis and only with the approval of senior management.

confidential information and its standards regarding price-service activities. The Board's policies and requirements with regard to handling of confidential information also apply to the opening, maintenance, and termination of an account for a designated FMU.

The Board also does not believe that doing its own evaluation of a designated FMU's compliance with the conditions for an account and then certifying to the Reserve Bank that the designated FMU meets all the requirements is the appropriate process. Accounts reflect deposit liabilities on the balance sheet of a Reserve Bank and risks associated with such accounts are borne by the Reserve Bank as the legal entity offering and maintaining such accounts. As such, the credit risk management functions in the Reserve Banks should have access to, and be able to perform, their own evaluation of a designated FMU's compliance with the conditions, both initially and on an ongoing basis.

*Reserve Bank accounts not mandatory.* One commenter stated that payment systems and other settlement arrangements have managed without their own Reserve Bank accounts for decades and designated FMUs should not be forced to shift their current account arrangements to Reserve Bank accounts under the Regulation HH framework. Title VIII of the Act allows the Board to authorize Reserve Bank accounts for designated FMUs, but it does not require them. A designated FMUs certainly may determine for business purposes that it does not have a need for an account offered at a Reserve Bank under the authority of § 806 of the Act. The Board or the Reserve Banks, however, may always require alteration of existing Reserve Bank account arrangements, even those maintained for designated FMUs under other authority, for legal, policy, or other purposes.

*Reserve Bank accounts covered by protection of netting contracts.* One

commenter stated that the Board should state as part of Regulation HH that any accounts covered by the regulation (and the corresponding credit balance accounts that the FMU would hold for the participants) would be exempt from garnishment, attachment, or similar process because any such action would amount to a “stay, injunction, avoidance, moratorium, or similar proceeding or order” that would “limit or delay application of otherwise enforceable netting contracts” and thus prohibited under 12 U.S.C. 4405.

Under 12 U.S.C. 4405, the statutory protection is applicable only with respect to netting contracts governed by 12 U.S.C. 4403 and 4404. Moreover, the stay in 12 U.S.C. § 4405 is self-actuating and applies as a matter of law. The Board does not have rulemaking authority with respect to that provision. There may be designated FMUs with Reserve Bank accounts established under the Board’s final rule that use netting contracts protected by 12 U.S.C. 4405, as well as designated FMUs with Reserve Bank accounts that do not have such netting contracts. However, section 4405 does not provide the Board with the authority to determine whether a garnishment, attachment, or similar process against a particular Reserve Bank account would amount to a violation of § 4405.

*Central counterparties under the Dodd-Frank Act regulatory regime.* One commenter raised concerns regarding the new regulatory regime for central counterparties under the Dodd-Frank Act, the implications of granting these entities “bank-like” privileges at the Reserve Banks, and the possibility that one or more FMUs will be bailed out at taxpayer expense. The commenter suggested that the Board undertake an exhaustive regulatory analysis regarding designated FMUs having access to Reserve Bank accounts and services, and that such analysis should include the broader implications of the Dodd-Frank Act’s transformation of the relationship between the



Federal Reserve and designated FMUs, including Federal Reserve exposure to losses, such as through overdrafts, and competitive impacts. The commenter states that providing Reserve Bank accounts and services to designated FMUs would “blur the line between FMUs and banks and thus make it easier for the Federal Reserve to provide support to these institutions without public notice or accountability.” The commenter suggests that the Board, before proceeding with this rulemaking, should consider revisiting the regulatory structure put in place by the Dodd-Frank Act because of the risks it causes CCPs to take on that could ultimately be borne by taxpayers.

The Board does not believe that the provision of Reserve Bank accounts and services to designated FMUs grants these entities broad “bank-like” privileges or makes it easier for these entities to receive support.<sup>11</sup> The use of Reserve Bank accounts and services by designated FMUs is for the narrow purpose of providing these critical market infrastructures a safer and more transparent option to collect and hold the financial assets, such as margins, required to cover their credit and liquidity risks. These financial assets are critical to the management of participant defaults and the mitigation of systemic risk in the financial system. Even within these narrow purposes, the Dodd-Frank Act provided authority to the Board to set any additional terms, conditions or limitations it believes necessary when authorizing a Reserve Bank to provide accounts and services to a designated FMU. The proposed rule in § 234.6(b) provides a set of minimum conditions in this regard that are intended to prevent any “undue credit, settlement, or other risk to the Reserve Bank” in providing accounts and services to designated FMUs.

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<sup>11</sup> As noted above and in the NPRM, the Board expects that Reserve Banks will provide accounts and services, and designated FMUs will structure their settlement processes and use of Reserve Bank accounts and services, in a manner that would seek to avoid inadvertent intraday account overdrafts where possible. In addition, the Board would expect a designated FMU to have the resources to promptly rectify any such overdrafts.

The Board may also set additional conditions on a case-by-case basis under § 234.6(a). The Board does not believe that a designated FMU's access to Reserve Bank accounts and services is intended to serve as a gateway for the FMU to offer general banking services or engage in financial activities unrelated to its market clearing and settlement activities.

The Board also does not believe that it can revisit the structure regarding central counterparties put in place by the Dodd-Frank Act. Rather, the Board is adopting regulations, as authorized by the Dodd-Frank Act, to achieve the intended benefits of such accounts and services, while preventing any undue risks to the Reserve Banks.

### **III. Administrative Law Matters**

#### *A. Final Regulatory Flexibility Act Analysis*

The Regulatory Flexibility Act (the "RFA") (5 U.S.C. 601 *et seq.*) generally requires an agency to perform an initial and a final regulatory flexibility analysis on the impact a rule is expected to have on small entities. However, under section 605(b) of the RFA, the regulatory flexibility analysis otherwise required under section 604 of the RFA is not required if an agency certifies, along with a statement providing the factual basis for such certification, that the rule will not have a significant economic impact on a substantial number of small entities. In this case, the final rule may apply to FMUs that are designated by the Council as systemically important to the U.S. financial system. Based on current information, the Board believes that the FMUs that have been and would likely be designated by the Council would not be "small entities" for purposes of the RFA, and so, the proposed rule likely would not have a significant economic impact

on a substantial number of small entities (5 U.S.C. § 605(b)). The authority to designate systemically important FMUs, however, resides with the Council, rather than the Board, and the Board cannot therefore be assured of the identity of the FMUs that the Council may designate in the future. Accordingly, a Final Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603, based on current information.

1. *Statement of the need for, objectives of, and legal basis for, the final rule.* The Board is finalizing additional regulations to implement certain provisions of Title VIII of the Dodd-Frank Act. Pursuant to section 806(a) of the Act, § 234.6 sets out conditions under which the Board would authorize a Federal Reserve Bank to establish and maintain an account for a designated FMU and provide the designated FMU services through the account. Pursuant to section 806(c) of the Dodd-Frank Act, § 234.7 sets out conditions for a Reserve Bank to pay interest on the balances maintained by a designated FMU at the Reserve Banks.

Under section 806 of the Act, all of these authorities are subject to any applicable rules or regulations that the Board may prescribe. The Board believes that the final regulations herein are necessary to provide guidance to the Federal Reserve Banks in implementing these authorities of the Act in an appropriate and uniform manner and to inform the affected institutions and the public of the conditions for obtaining Reserve Bank accounts and services. These regulations do not address Reserve Bank lending to designated FMUs in unusual or exigent circumstances pursuant to Dodd-Frank Act section 806(b).

2. *Small entities affected by the final rule.* The final rule affects FMUs

that the Council designates as systemically important to the U.S. financial system. The Council has designated eight FMUs that would meet these conditions and be affected by this final rule. Pursuant to regulations issued by the Small Business Administration (the “SBA”) (13 CFR 121.201), a “small entity” includes an establishment engaged in (i) financial transaction processing, reserve and liquidity services, and/or clearinghouse services with an average revenue of \$35.5 million or less (NAICS code 522320); (ii) securities and/or commodity exchange activities with an average revenue of \$35.5 million or less (NAICS code 523210); and (iii) trust, fiduciary, and/or custody activities with an average revenue of \$35.5 million or less (NAICS code 523991). Based on current information, the Board does not believe that any of the FMUs that have been or would likely be designated by the Council would be “small entities” pursuant to the SBA regulation.

3. *Summary of the significant issues raised by public comment on Board’s initial Analysis, the Board’s assessment of such issues, and a statement of any changes made as a result of such comments.* The Board did not receive any public comments regarding its initial regulatory flexibility analysis for this rulemaking. In addition, the Board did not receive any comments from the Chief Counsel for Advocacy of the Small Business Administration in response to the proposed rule.

4. *Reporting, recordkeeping, and other compliance requirements.* The final rule does not impose any explicit reporting or recordkeeping requirements, but does impose certain other compliance requirements for a designated FMU in order to receive the benefits of a Reserve Bank account and services. As noted above, section 234.6(b) establishes minimum conditions for a designated FMU to establish and maintain an

account with a Reserve Bank or receive financial services from a Reserve Bank, such as being in generally good financial condition, being in compliance with Federal Reserve policies and other requirements regarding accounts and services, and having an ongoing ability to meet all its obligations under its agreement for a Reserve Bank account and services. In addition, pursuant to Dodd-Frank Act section 806(a) and section 234.6(a) of the final rule, the Board may impose other limitations, restrictions, or other requirements in its authorization to the Reserve Bank to establish the account for a particular designated FMU. Finally, other compliance requirements may be contained in the Reserve Bank's agreements for the account and services, including notice, reporting, or recordkeeping requirements with respect to particular designated FMU. The types of professional skills necessary to comply with these requirements may include accounting, legal, payments, and risk management. All of these skill sets should be available within a designated FMU's corporate structure.

5. *Significant alternatives to the final rule.* The Board considered several alternatives to the provisions being adopted by this final rulemaking. As noted above, the Board believes promulgation of regulations is necessary to provide guidance to the Federal Reserve Banks in implementing sections 806(a) and (c) of the Dodd-Frank Act in an appropriate and uniform manner and to inform the affected institutions and the public of the minimum conditions for obtaining Reserve Bank accounts and services. The Board considered alternative forms of the regulations, in particular balancing the amount of detail included in the minimum requirements for Reserve Bank accounts and services to inform the designated FMUs of the minimum conditions as well as preserve flexibility for the Reserve Banks in applying the minimum conditions to designated FMUs that vary

considerably in corporate structures, business models, and risk profiles. As discussed above in this notice, the Board has included more detail regarding specific minimum conditions in response to public comments that requested the designated FMUs be provided with more clarity regarding how the requirements would be applied. The Board believes that the provisions in the final rule strike the appropriate balance between these objectives.

*B. Paperwork Reduction Act Analysis*

In accordance with the Paperwork Reduction Act of 1995 (44 USC 3506; 5 CFR 1320, Appendix A.1), the Board reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget. The final rule contains no requirements subject to the PRA.

**IV. Statutory Authority**

Pursuant to the authority in Title VIII of the Dodd-Frank Act and particularly sections 806(a) and (c) (12 U.S.C. 5465(a) and (c)), the Board proposes two new sections to part 234 (Regulation HH).

**Text of Final Rules**

**List of Subjects in 12 CFR 234**

Banks, Banking, Commodity futures, Credit, Electronic funds transfers, Financial market utilities, Securities.

## **Authority and Issuance**

For the reasons set forth in the preamble, the Board is amending 12 CFR part 234, as set forth below.

### **PART 234 - DESIGNATED FINANCIAL MARKET UTILITIES (REGULATION HH)**

1. The authority citation for part 234 continues to read as follows:

**Authority:** 12 U.S.C. 5461 *et seq.*

2. In § 234.1 revise paragraph (b) to read as follows:

#### **234.1 Authority, purpose, and scope.**

\* \* \* \* \*

(b) *Purpose and scope.* This part establishes risk-management standards governing the operations related to the payment, clearing, and settlement activities of designated financial market utilities. In addition, this part sets out requirements and procedures for a designated financial market utility that proposes to make a change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the designated financial market utility and for which the Board is the Supervisory Agency (as defined below). The risk management standards do not apply, however, to a designated financial market utility that is a derivatives clearing organization registered under section 5b of the Commodity Exchange Act (7 USC 7a-1) or a clearing agency registered with the Securities and Exchange Commission under section 17A of the Securities Exchange Act of 1934 (15 USC 78q-1), which are governed by the risk-management standards promulgated by the Commodity Futures

Trading Commission or the Securities and Exchange Commission, respectively, for which each is the Supervisory Agency. This part also sets out standards, restrictions, and guidelines regarding a Federal Reserve Bank establishing and maintaining an account for, and providing services to, a designated financial market utility. In addition, this part sets forth the terms under which a Reserve Bank may pay a designated financial market utility interest on the designated financial market utility's balances held at the Reserve Bank.

3. Add §§ 234.6 and 234.7 to read as follows:

**§ 234.6 Access to Federal Reserve Bank accounts and services.**

(a) This section applies to any designated financial market utility for which the Board may authorize a Federal Reserve Bank to open an account or provide services in accordance with section 806(a) of the Dodd-Frank Act. Upon receipt of Board authorization and subject to any limitations, restrictions, or other requirements established by the Board, a Federal Reserve Bank may enter into agreements governing the details of its accounts and services with a designated financial market utility, consistent with this section and any other applicable Board direction. The agreements may include, among other things, provisions regarding documentation to establish the account and receive services, conditions imposed on the account and services, service charges, reporting, accounting for activity in the account, liability and duty of care, and termination.

(b) A Federal Reserve Bank should ensure that its establishment and maintenance of an account for or provision of services to a designated financial market utility does not create undue credit, settlement, or other risk to the Reserve Bank. In order to establish



and maintain an account with a Federal Reserve Bank or receive financial services from a Federal Reserve Bank, the designated financial market utility must be in compliance with the Supervisory Agency's regulatory and supervisory requirements regarding financial resources, liquidity, participant default management, and other aspects of risk management, as determined by the Supervisory Agency. In addition, at a minimum, the designated financial market utility must, in the Federal Reserve Bank's judgment –

- (1) Be in generally sound financial condition, including maintenance of sufficient working capital and cash flow to permit the designated financial market utility to continue as a going concern and to meet its current and projected operating expenses under a range of scenarios;
- (2) Be in compliance with Board orders and policies, Federal Reserve Bank account agreements and, as applicable, operating circulars, and other applicable Federal Reserve requirements regarding the establishment and maintenance of an account at a Federal Reserve Bank and the receipt of financial services from a Federal Reserve Bank; and
- (3) Have an ongoing ability, including during periods of market stress or a participant default, to meet all of its obligations under its agreement for a Federal Reserve Bank account and services, including by maintaining -
  - (i) Sufficient liquid resources to meet its obligations under the account agreement;
  - (ii) The operational capacity to ensure that such liquid resources are available to satisfy the account obligations on a timely basis in accordance with the account agreement; and
  - (iv) Sound money settlement processes designed to adequately monitor its Federal Reserve Bank account on an intraday basis, process money transfers through its account in an orderly manner, and complete final money settlement no later than the value date.

(c) The Board will consult with the Supervisory Agency of a designated financial market utility prior to authorizing a Federal Reserve Bank to open an account, and periodically thereafter, to ascertain the views of the Supervisory Agency regarding the designated financial market utility's compliance with the requirements in paragraph (b) of this section.

(d) In addition to any right that a Reserve Bank has to limit or terminate an account or the use of a service pursuant to its account agreement, the Board may direct the Federal Reserve Bank to impose limits, restrictions, or other conditions on the availability or use of a Federal Reserve Bank account or service by a designated financial market utility, including directing the Reserve Bank to terminate the use of a particular service or to close the account. If the Reserve Bank determines that a designated financial market utility no longer complies with one or more of the minimum conditions in subsection (b), the Reserve Bank will consult with the Board regarding continued maintenance of the account and provision of services.

**§ 234.7 Interest on balances.**

(a) A Federal Reserve Bank may pay interest on balances maintained by a designated financial market utility at the Federal Reserve Bank in accordance with this section and under such other terms and conditions as the Board may prescribe.

(b) Interest on balances paid under this section shall be at the rate paid on balances maintained by depository institutions or another rate determined by the Board from time to time, not to exceed the general level of short-term interest rates.

(c) For purposes of this section, "short-term interest rates" shall have the same meaning as the meaning provided for that term in §204.10(b)(3) of this chapter.

**By order of the Board of Governors of the Federal Reserve System, December 5, 2013.**

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**Robert deV. Frierson,  
Secretary of the Board.**

Billing Code: 6210-01-P

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